IN THE HIGH COURT OF HIMACHAL PRADESH SHIMLA

Company Appeal No.3 of 2005
&
Company Appeal No.6 of 2005

Judgment reserved on: 16.4.2007

Date of decision: 17th May, 2007.

Co.Appeal No.3/2005:

Morepen Laboratories Ltd. …..Appellant

-Versus-

Union of India and others ….Respondents

Co.Appeal No.6 of 2005:

Union of India ….Appellant

-versus-

Morepen Laboratories Ltd. And another ….Respondents

Coram:

The Hon'ble Mr.Justice Deepak Gupta, Judge.

The Hon'ble Mr.Justice Surinder Singh, Judge.

Whether approved for reporting? Yes

In Co.Appeal No.3/2005:

For the Appellant: M/s. B.C. Negi, Aman Sood, P.K.Singh, Biju Mattam, Advocates.
Mr.Dalip Sharma, Advocates.
For Respondent: Mr.Umapati, Advocate for UOI.

In Co.Appeal No.6 of 2005:

For the Appellants: Mr.Umapati, Advocate.
For Respondents: M/s. B.C. Negi, Aman Sood, P.K.Singh, Biju Mattam, Advocates.

Deepak Gupta, J.

By this judgment we are disposing of two Company appeals as they are both directed against the same order passed by the Company Law Board (CLB) dated 16.6.2005.

M/s.Morepen Laboratories Ltd., (hereinafter referred to as the Company) was incorporated in the year 1984 as a Private Limited company. It was re-constituted as a Public Limited Company on 16th March, 1992. The Company is engaged in the pharmaceutical business. To meet its capital requirement the Company had invited deposits from the public in the year 1993. The Company was unable to re-pay the matured deposits and various complaints were made by the depositors to the CLB. The CLB on 8.8.2003 came to the conclusion that the Company had defaulted in the payment of the deposits from October, 2002. In its order dated 8.8.2003 the CLB recorded that the outstanding position of the fixed deposits as on 31.3.2003 was Rs.16183.76 lakhs and this amount was owned by the Company to 85921 depositors.

The CLB took cognizance of the matter under Section 58-A(9) of the Indian Companies Act (hereafter referred to as the Act). The Company was asked to furnish the reasons for its default and the plan of action to clear all the matured deposits and the deposits which would mature in the future. Various options were placed before the CLB by the Company for discharging its liabilities. The CLB passed the following order after hearing the parties on 8.8.2003:

> "(i)The interest payable will be the contracted rate upto the date of maturity and at 7% per annum after the date of maturity;
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> (ii)All deposits upto Rs.5,000/- payment will be made within one year from the date of maturity;
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> (iii)All deposits of Rs.5001/- to Rs.20,000/- shall be paid within 4 years from the date of maturity at 20% in the first year, 20% in the second year, 20% in the third year and balance 40% in the

fourth year. The interest for both pre and post maturity period will be paid alongwith the last instalment.

(iv)All deposits of Rs.20,001/- to Rs.50,000/- shall be paid within four years from the date of maturity at 15% in the first year, 20% in the second year, 25% in the third year and balance 40% in the fourth year. The interest for both pre and post maturity period will be paid along with the last instalment.

(v)All deposits of Rs.50,001/ and above shall be paid within four years from the date of maturity at 10% in the first year, 15% in the second year, 35% in the third year and balance 40% in the fourth year. The interest for both pre and post maturity period will be paid along with the last instalment.

(vi)The company shall issue post dated cheques for first instalment to all the depositors who have submitted/surrendered the original fixed deposit receipt, on demand by the Company.

(vii)The above scheme will be applicable to all depositors whether over due or yet to mature and whether any application has been filed before the Company Law Board or not.

(viii)the scheme shall be effective from the date of this order."

Certain guidelines were also issued to the Company and Shri Sushil Suri, Director of the Company was directed to file an affidavit undertaking therein that the above scheme would be implemented without fail.

The Company filed affidavits dated 3.11.2003 and 30.2.2004 in the office of the Registrar of Companies, Jallandher which according to the Union of India were found to be incomplete. According to the Union of India the Company did not comply with the orders of the

CLB. Though as per terms of the order the Company was required to make payment of Rs.1428.66 lakh during the period 19.8.2003 to 31.1.2004 the Company actually paid a sum of Rs.555.44 lakhs only. It is the admitted case of the parties that the Company did not make payments to the depositors as per the scheme approved by the CLB vide its order dated 19th August, 2003. Thereafter, the Central Government filed a petition under Section 408 read with Sections 397 and 398 of the Act praying that six Government Directors be appointed for a period of 3 years on the Board of the Company. The allegation against the Company was that though it had failed to repay the public debts and comply with the orders of the CLB it had diverted a sum of over Rs.65 crores by making investments in associate Companies. It was also alleged that the Company had without giving any logical reasoning made a provision for Rs.126 crores in regard to outstanding debtors and had written off this amount whereas in the previous year the amount under this head was only Rs.84 lakhs. Various other violations made by the Company were pointed out with a view to show that the Company was not being run in a proper manner and that the accounts of the Company were not being properly maintained. The Company contested this application. The CLB noticed that despite specific directions given from time to time the Company avoided to give the complete reply in regard to the status of the repayment of the deposits. The CLB after considering the entire case partly allowed the application filed by the Central Government and ordered that two Government Directors be appointed to monitor and assist the Company for a period of 3 years.

Aggrieved by the aforesaid orders the Company filed Appeal No.3 of 2005 and it is the contention of the Company that no case is

made out for appointment of Government Directors. The Union of India has filed Company Appeal No.6 of 2003 and according to the Central Government its prayer for appointment of six Directors was genuine and therefore six Directors should have been permitted to be appointed.

We have heard Sh.B.C. Negi, learned counsel for the Company and Sh.Umapati, learned counsel for the Union of India.

Sh.B.C. Negi, learned counsel for the Company has submitted that the Company has been unable to comply with the orders dated 19.8.2003 passed by the CLB for reasons beyond its control. According to Sh.Negi the Company's business is global in nature. It is the case of the Company that it had successfully developed a product called "Loratadine". The Company had applied to the USFDA for certification of this drug. The patent for the produce was to expire in the year 2000 but this patent was extended by USFDA for a period of more than 2 years and therefore the Company could not export its produce to USA which led to it facing cash problems. It is also the case of the Company that it had floated a global depository receipt issue, and this issue was subscribed to the extent of 53.25 million US dollars. However, this money could not be utilized by the Company due to orders passed by the Debt Recovery Tribunal on 29.4.2003. The stand of the Company further is that it has approached the Company Judge of this Court by filing a petition under Section 391 of the Act and it is contended that till such proceedings are pending no coercive action should be taken against the Company. The case of the Company further is that its case for re-structuring of the loans availed by it is pending before the Corporate Debt Re-structuring Cell (CDRC) and a Review

Committee has been appointed by the CDRC and the entire affairs of the Company are subject to approval under the CDRC Mechanism and therefore there is no need to appoint independent Directors. It is lastly contended that Section 58 of the Act is a complete Code in itself and non-compliance of the orders passed by the CLB under Section 58 may lead to prosecution of the Company but cannot be a ground for appointment of Government Directors. It is also contended that in case the Government Directors are appointed the Company which is now resurgent will loose its credibility in the public eye and this may adversely affect the Company.

On the other hand Mr.Umapati, learned counsel for the Union of India contends that the record of the Company with regard to the payment of the public moneys is absolutely dismal. According to him the Company has failed to fulfill its obligations under the orders of the CLB. It is also contended that the Company has miserably failed to pay off the public depositors who are poor persons and it is alleged that the funds of the Company are being siphoned off and as such the Company should be permitted to appoint six Directors so that it has majority say in the running of the Company.

Before considering the factual aspect of the matter reference may be made to Section 408(1) of the Act which reads as follows:

> "**408.Powers of government to prevent oppression or mismanagement.-**(1) Notwithstanding anything contained in this Act, the Central government may appoint such number of persons as the Company Law Board may, by order in writing, specify as being necessary to effectively safeguard the interests of the company, or its shareholders or the public interests to hold office as directors thereof for such period, not exceeding three years on

any one occasion, as it may think fit, if the Company Law Board on a reference made to it by the Central Government or on an application of not less than one hundred members of the company or of the members of the company holding not less than one-tenth of the total voting power therein, is satisfied, after such inquiry as it deems fit to make, that it is necessary to make the appointment or appointments in order to prevent the affairs of the company being conducted either in a manner which is oppressive to any members of the company or in a manner which is prejudicial to the interests of the company or to public interest:

Provided that in lieu of passing an order as aforesaid, the company Law Board may, if the company has not availed itself of the option given to it under section 265, direct the company to amend its articles in the manner provided in that section and make fresh appointments of directors in pursuance of the articles as so amended, within such time as may be specified in that behalf by the Company Law Board."

A bare reading of the aforesaid Section shows that the essential ingredient for invoking the provision of the aforesaid Section is that the Central Government must be satisfied that the appointment of the Directors is required with a view to prevent the affairs of the Company being conducted either in a manner which is oppressive to any member of the Company or in a manner which is prejudicial to the interest of the Company or to public interest.

In the present case the main concern is the public interest. If it can be shown that the affairs of the Company are being conducted in a manner which is prejudicial to the public interest then the order of the CLB is justified. The powers under Section 408 of the Act are to be sparingly used and it is only if the CLB is satisfied that the affairs of the Company are being conducted in a manner which is prejudicial to public interest that the order can be passed.

It is also a well settled principle of law that it is not necessary that to invoke the powers under Section 408 the damage should have already taken place. The powers of the Central Government under Section 408 are preventive in nature and can be exercised in order to ensure that in future the affairs of the Company are not conducted in a manner which is prejudicial to the public interest. An order under Section 408 may not be able to cure the illegal or prejudicial act which may already have been performed but can be used to prevent further damage. Reference in this behalf is made to a judgment of the Delhi High Court passed in **Sakthi Trading Co.P.Ltd. and another vs. Union of India and another, 1985 (vol.57) Company Cases 789.**

In the present case the admitted facts are that the Company has been unable to comply with the orders of the CLB and pay off the public depositors. The explanation of the Company that it could not comply with the orders of the CLB due to the fact that its produce 'Loratadine' could not be sold in the US market and that the global deposit receipts could not be utilized cannot be accepted. Both these circumstances were already in existence when the order dated 8.8.2003 was passed by the CLB. At that time the Company itself had given various options to the CLB to pay off all the depositors. The CLB passed directions. This order of the CLB has attained finality and in our considered opinion the Company should have cleared the public debt in accordance with the orders of the CLB. The Company in fact had not fulfilled its obligations and instead has diverted the funds to various other parties. We cannot loose sight of the fact that thousands of pensioners, widows and other members of the public have invested their funds in the Company. The Company's accounts should be above

board. No doubt in commercial transactions there may be instances when a Company may loose money but the totality of circumstances has to be seen while adjudicating whether the affairs of the Company are being run in a manner which may be prejudicial to the public interest.

There are certain facts which have not been controverted before us. The first is that instead of servicing the public debt and repaying the depositors the Company has invested a sum of Rs.67.75 crores in shares of associated Companies. Sh.Negi has been at pains to explain that there has not been any outflow of funds from the Company and these investments are in the nature of book transfers. We are unable to accept the explanation. Admittedly the Company had invested huge amounts in its sister company Dr.Morepen Ltd. The Annual report for the year 2002-2003 shows that the Company off-loaded its investment and Dr.Morepen ceased to be a subsidiary of the Company. Thereafter, this Company again became a subsidiary a couple of years later. There is sufficient material on record to show that more than Rs.67 crores has been diverted to other Companies out of the funds of the Company. This money could have been better utilized to pay off the public debt.

Another factor which shows that the affairs of the Company are not being run property is that the Company has made a provision for writing off outstanding debts of Rs.126.25 crores as non-recoverable on 30th September, 2003. In the previous year the outstanding debts were less than Rs.one crore. The Company has failed to explain how an increase of Rs.124 crores in the bad debts has taken place in a period of less than one and a half years. Despite our repeated queries in the matter no proper answer could be given by the counsel appearing for the Company.

It would also be pertinent to mention even as per the report of the Chartered Accountants of the Company itself the accounts are not being property maintained. It is now being tried to be projected that the Company is doing well and is making profit. However, if the note of the Chartered Accountant is taken into consideration it appears that this projection made by the Company is also incorrect. The note of the Chartered Accountant attached with the annual report of the year 2001-2003 reads as follows:

> "i)Note no.3.6 of I regarding pending proposal of the company with financial institutions/banks for restructuring of debt under Corporate Debt Restructuring (CDR) mechanism, the company has not provided for interest amounting to Rs.7230.29 lacs of financial institutions and banks as a result the figures of loss for the period, secured loans and unsecured loans are under stated by Rs.7230.29 lacs, Rs.6236.02 lacs and Rs.994.27 lacs respectively. Ii)Note No.11.2 of I regarding balances shown under loans and advances are subject to reconciliation/ settlement and pending its consequential adjustments, if any."

The argument made on behalf of the Company that Section 58 of the Act is a complete code in itself and therefore non-compliance of the orders passed under Section 58 cannot be a ground for appointment of Government Directors is an argument of despair and has been made only to be rejected. No doubt in case there is non-compliance to the orders passed by the CLB under Section 58 the Directors of the Company can be prosecuted. However, the Company cannot be heard to say that though it may have mis-managed its affairs to the prejudice of the public, provisions of Section 408 should not be invoked. Both the penal provisions of Section 58 and the supervisory control provisions under Section 408 can be invoked. As stated above Section

408 is preventive in nature. For the damage already done the Directors can be prosecuted under Section 58. However, to prevent future mal-administration of the Company in a manner prejudicial to the affairs of the public it is necessary to appoint Government Directors. This Court while looking into such a matter has to also keep in mind that the Company is in default of repayment of outstanding secured debts to the extent of Rs.656.07 crores as on 30.9.2003 and large numbers of petitions for winding up filed against the Company are pending in this Court. The Company has also outstanding unsecured loans to the extent of Rs.271.58 crores (inclusive of fixed deposits) as on 30.9.2003. The debts of the Company are almost about Rs.1000 crores.

Keeping all the above factors into consideration, we are of the view that the affairs of the Company are being run in a manner prejudicial to the public interest.

The last argument of Sh.Negi is that in case Government Directors are appointed it will affect the credibility of the Company in the market. This may be so. An order under Section 408 of the Act can only be passed if we come to the conclusion that the affairs of the Company are not being managed properly. We have already held that the affairs of the Company are being run in a manner prejudicial to the public interest. This is a situation which has arisen due to the mis-management by the persons presently holding the reins of the Company. On the one side is the larger public interest and on the other side is the prejudice which may be caused to the present management of the Company. In our considered view the larger public interest must prevail and therefore this contention is rejected.

We may also note that though no stay order was granted in the appeal filed by the Company, till date the Company has failed to accept the two Directors appointed by the Government has not even permitted the said Directors to attend a single meeting of the Board of Directors of the Company.

As far as the appeal of the Central Government is concerned, we are of the view that the purpose of Section 408 is to ensure that the Government Directors are appointed to act like a watch dogs to ensure that the affairs of the Company are run in a proper manner. Purpose of Section 408 is not to give majority vote to the Company but the purpose is only to ensure that the affairs of the Company are run properly. We are therefore not inclined to agree with the Central Government that six Directors should be appointed.

Keeping in view the above discussion we find no error in the order of the CLB. Both the appeals are accordingly dismissed.

Since the Company has failed to comply with the order of the CLB till date we direct that the Company shall hold a meeting of the Board of Directors within two months from today in which it shall associate the two Directors appointed by the Central Government and that the terms of 3 years for the said Directors will start from the day the first meeting is held. With these directions, both these appeals are disposed of. No costs.

(Deepak Gupta)
Judge

May 17, 2007.
PV

(Surinder Singh),
Judge